April 21, 2011

California Debt and Investment Advisory Commission

Discussion Materials

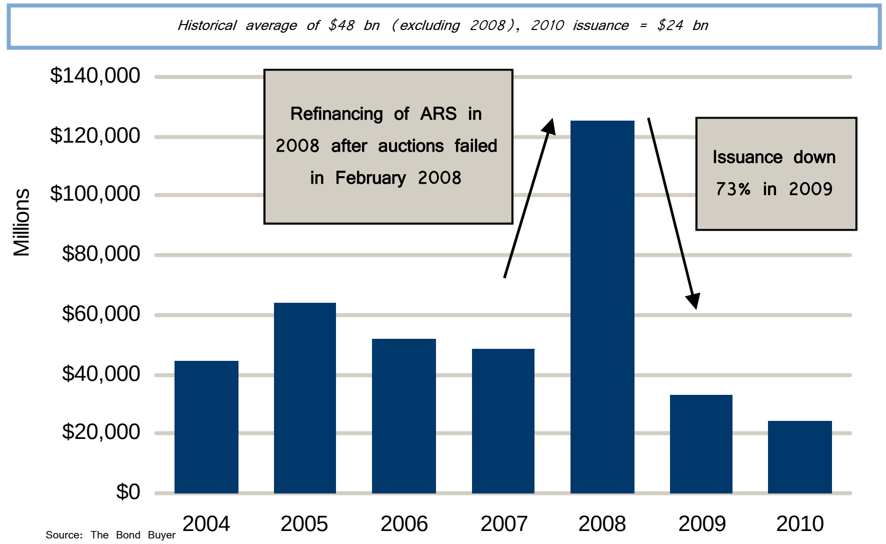
Ken Gambone
Phone: (212) 526-2093
Director
Fax: (646) 758-1905
E-mail: kenneth.gambone@barclayscapital.com

Recent Short-Term Market Trends

Market dynamics continue to keep SIFMA Index resets near historic lows

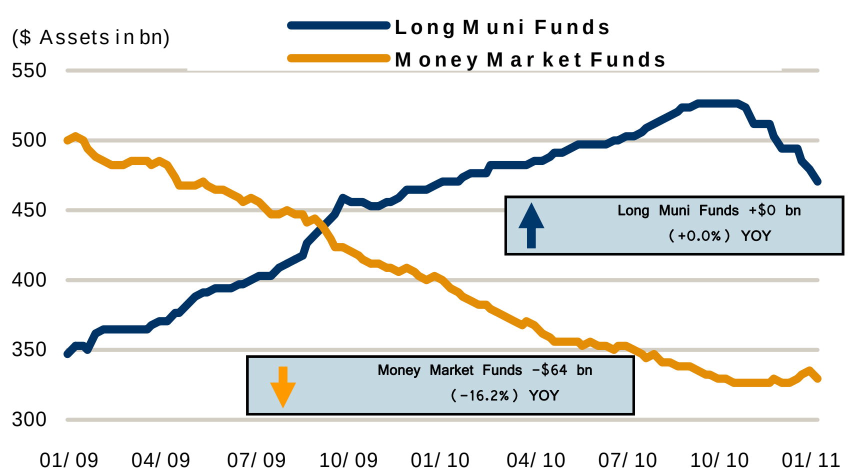
- Tax-exempt money market funds lost assets at an unprecedented pace in 2010, ending the year with $328.5 billion of assets under management – a level last seen in November 2005
- $80 billion of bank liquidity renewals for municipal issuers is expected in 2011
- SIFMA continues to hover near its all-time low and has not exceeded 0.50% since September 2009

VRDB Issuance Trends



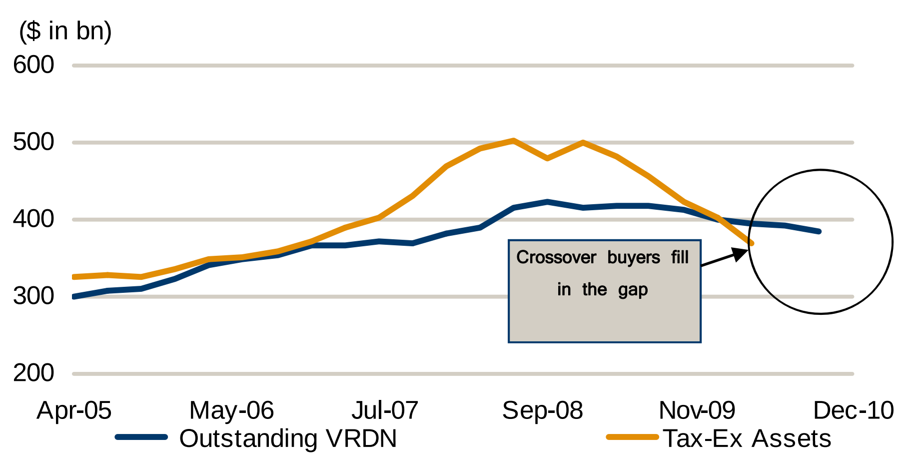
Source: The Bond Buyer

Institutional Flow of Funds Change



Source: iMoneyNet

Outstanding VRDNs > Tax-Exempt Assets by $50b



Source: iMoneyNet/Thomson Reuters Municipal Market Data

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Potential 2011 trends in the tax-exempt note market

Demand for traditional 1-year notes may be impacted by tax-exempt money market funds declining asset balances

Historical Note Issuance					
Year	Note Issuance ($ millions)	Total MMF Assets Year-End ($ millions)	Notes as a % of MMF Assets	15% of MMF Assets Year-End ($ millions)	MMD 1 Year at Year-End
2005	$51,316	$345,440	15%	$51,816	3.20
2006	$44,032	$375,169	12%	$56,275	3.50
2007	$58.029	$476,330	12%	$71,450	2.90
2008	$60,817	$491,814	12%	$73,772	0.85
2009	$64.,49	$399,636	16%	$59,945	0.28
2010	$65,322	$328,504	20%	$49,276	0.37
2011*	$2,795	$322,195	--	$48,329	0.32
Average:	$343,443	$391,298	14%	$58,695	1.63

Source: The Bond Buyer/iMoneyNet

- SEC Rule 2a-7 rule changes reduce money market fund WAM from 90 days to 60 days and initiate a WAL calculation of 120 days.
- A MMF portfolio of 85% 7-day VRDBs and 15% 1-year notes would achieve a WAM of 60 days
- Historically low current interest rates combined with the expectation of rising interest rates in 2012 have created demand for indexed notes.
- More demand may come from bifurcated maturities and SIFMA index notes

Stricter New 2a-7 Rules for Money Market Funds

Summary of Key, New Provisions of 2a-7

- Improved Liquidity: The new rules require money market funds to have a minimum percentage of their assets in highly liquid securities so that those assets can be converted to cash to pay redeeming shareholders. Currently, there are no minimum liquidity mandates. All money market funds must have at least 30% of assets invested in cash equivalent securities with remaining maturities of 60 days or less, or securities that can be converted into cash within one week.

Effect: Increased demand for shorter maturities/puts like weekly reset VRDBs

- Shorter Maturity Limits: The maximum weighted average maturity (WAM) will be reduced from 90 to 60 days and weighted average life (WAL) will be limited to 120 days or less (currently there is no WAL restriction).

Effect: Increased demand for shorter maturities/puts like weekly reset VRDBs

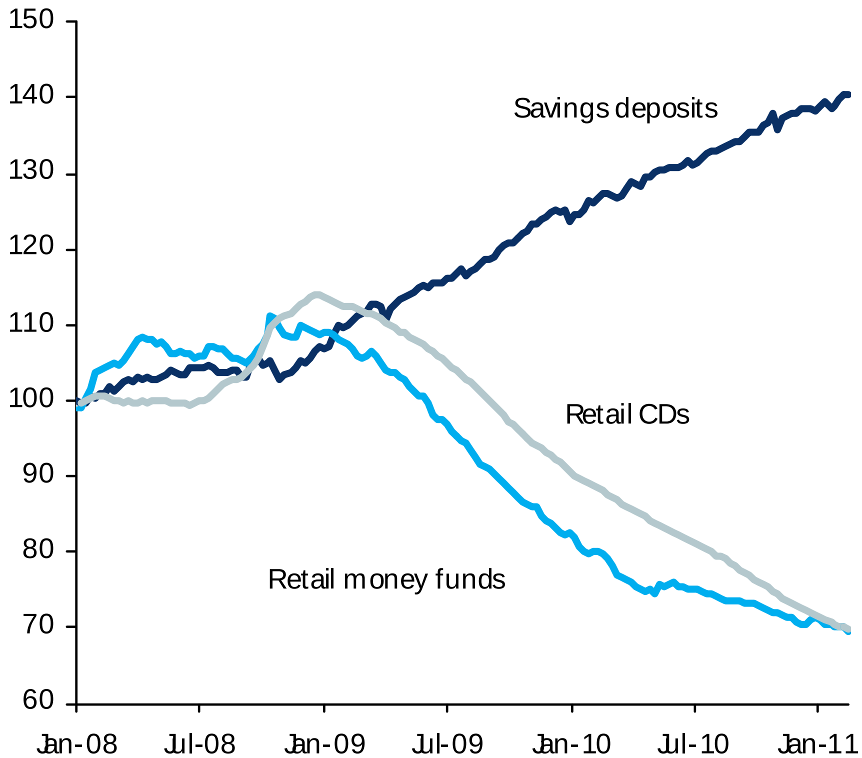
- Higher Credit Quality: Money market funds will be limited to no more than 3% of their holdings in tier-2 securities (rather than the current limit of 5%). Additionally, MMFs will be restricted from purchasing tier-2 securities that mature in more than 45 days (rather than the current limit of 397 days).

Effect: Increased demand for shorter maturities/puts like weekly reset VRDBs

Most funds are already compliant with the new rules

Money fund competition from banks

Deposits and retail money funds (Jan-08=100)



Source: Federal Reserve

- Bank savings deposits have increased sharply over the past two years.
  - But banks are shedding certificates of deposit
- Prolonged low rates could encourage more corporate treasurers to "do-it-yourself" – that is, bypass the money funds entirely
  - But staying invested in the front end

Dodd-Frank contains a provision that will provide unlimited deposit insurance to banks

- Coverage applies to non-interest bearing transaction accounts only
- And there is no explicit charge for the coverage

With money fund yields approaching 0%, we expect some institutional money to flow into bank deposits

- But the amount of money fund outflows will depend critically on the premium that depositors place on government-backed insurance

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Basel III Update

Once fully implemented, Basel III could significantly impact the cost and availability of bank facilities

- Basel III responds to the recent financial crisis by imposing regulations designed to better prepare banks for periods of stress
- Reforms will be phased in over the course of the next 13 years, with most of the changes taking effect by 2018

Improved Capital Quality

- Narrower definition of Tier 1 capital
- More conservative risk weighting
- Elimination of Tier 3 capital category

Improved Capital Quantity

- Tier 1 Common raised from 2% to 4.5%; Tier 1 Total Capital increased from 4% to 6%
- Capital conservation buffer of 2.5%
- Countercyclical buffer of 0-2.5%

Introduction of Leverage Ratios

- Designed to supplement capital standards to provide greater security
- Assets calculated at full value and not risk-weighted
- Ratio of Tier 1 capital to net exposure must be at least 3%

Introduction of Liquidity Metrics

- Contemplates a liquidity coverage ratio and a net stable funding ratio
- Both metrics require significant calibration and are scheduled for roll-out in January 2015 and January 2018, respectively

Proposed regulations will likely have the cumulative effect of increasing the cost of capital for banks in countries that comply with Basel III

New Disclosure Requirements in the Municipal Short Term Market

SEC disclosure rule 15c2-12 is now applicable to municipal issuers of variable rate demand bonds

- On December 1, 2010 the SEC will mandate all new issue VRDBs as subject to Rule 15c2-12 and continuing disclosure. Existing VRDBs issued prior to this date will be grandfathered
- The information required to be provided by municipal issuers consists of the following:
  - Notices of the occurrence of any of the following 11 events in "a timely manner not in excess of 10 business days after the occurrence of the event": Principal and interest payment delinquencies; Non-payment related defaults; Unscheduled draws on debt service reserves reflecting financial difficulties; Unscheduled draws on credit enhancements reflecting financial difficulties; Substitution of credit or liquidity providers, or their failure to perform; Adverse tax opinions or events affecting the tax-exempt status of the security; Modifications to rights of security holders; Bond calls; Defeasances; Release, substitution, or sale of property securing repayment of the securities; Rating changes
- While the rule currently requires disclosure of any of the 11 events above *only if they are material*, the proposed amendments would require the occurrence of the events underlined above to be disclosed under any circumstances

- Beginning on May 16, 2011, the MSRB will mandate remarketing agents to report through EMMA the identity of liquidity providers, tender agents, the par amount of bank bonds, and the par amount of VRDBs held by parties other than the liquidtiy provider.

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